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SUBJECT: 2007 INVESTMENT CLIMATE REPORT - COSTA RICA

REF: STATE 178303

¶1. The 2007 Investment Climate Report requested in reftel follows. As instructed the following report has also been submitted via unclassified email.

2007 Investment Climate Statement for Costa Rica

A.1. OPENESS TO FOREIGN DIRECT INVESTMENT

Costa Rica has a generally open international trade and investment regime, with the exception of a few sectors that are reserved for state companies. Two high profile parastatals will lose their monopolies if the U.S.-Central America-Dominican Republic Free Trade Agreement (CAFTA-DR) is ratified and implemented. For several years, the government of Costa Rica has campaigned at senior levels to attract high quality foreign investment to Costa Rica, a policy which is a high priority for the administration of President Oscar Arias that took office in May 2006. The Costa Rican investment and development board (CINDE) leads these investment promotion efforts through offices in Costa Rica, the United States, Europe, and the Far East. The country's commercial code details all business requirements necessary to operate in Costa Rica. The laws of public administration and public finance contain most requirements for contracting with the state. All businesses must be registered in the national registry, thereby becoming national companies that may have national or foreign owners. The investment requirements for foreign and national persons and companies are identical. Businesses may be established starting from nothing, acquired, merged with, or taken over in much the same way as is done in the U.S. Foreign partnerships with local businesses are quite common.

The judicial system generally upholds contracts, but caution should be exercised when making investments in sectors reserved or protected by the constitution or by laws for public operation. Investments in state-protected sectors under concession mechanisms can be especially complex due to regular challenges in the constitutional court of contracts permitting private participation in state enterprise activities.

The Arias administration has stated an interest in using the 1998 concessions law to build infrastructure and manage public works projects. One new concession agreement for the operation of the country's principal Pacific port commenced successful operation in the latter half of 2006. However, several earlier concession agreements negotiated under the 1998 law have encountered and continue to face

very serious difficulties, including cancellations, when these agreements have been reviewed by the GOCR comptroller general and supreme court. The administration has proposed legislative changes to remedy defects in the 1998 law, changes which are expected to become law in early 2007.

Industry surveys by CINDE and the Costa Rican foreign trade corporation (PROCOMER) suggest that investors are most attracted by Costa Rica's economic and political stability and a well educated workforce. On August 5, 2004, Costa Rica, together with El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic, signed the U.S.-Central America - Dominican Republic Free Trade Agreement (CAFTA-DR) with the United States. Although Costa Rica is the only signatory that has not ratified the agreement it is generally believed that a majority of the full legislature favor ratification of the treaty which is expected to occur in mid-2007. To bring the treaty into force several laws and regulations must be changed to conform with treaty provisions. Especially difficult will be laws opening the telecommunications and insurance sectors to competition.

While the government focuses on promoting foreign investment in export industries, foreign franchises have prospered in the domestic market for the past thirty years. Investments have been made in a wide array of sectors, including fast food (such as Taco Bell, Kentucky Fried Chicken, Pizza Hut, Domino's Pizza, Papa John's Pizza, McDonald's, Burger King, Subway, and TCBY Yogurt), car rentals (including Hertz, Avis, Dollar, and Budget), hotels (such as Marriott, Intercontinental, Regents, Hampton Inn, and Best Western,), and designer clothing boutiques (including Tommy Hilfiger and Liz Claiborne). Price Smart (formerly Price Club in the U.S.) has opened four Costa
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Rican stores since mid-1999. In March 2006, Wal-Mart acquired a 51% interest in a local grocery-store holding company and brought it under the aegis of Wal-Mart Central America. Wal-Mart Central America is the region's largest retailer, with 394 supermarkets and 23,000 associates in Costa Rica, Guatemala, El Salvador, Honduras, and Nicaragua.

A.2. CONVERSION AND TRANSFER POLICIES

There are no restrictions on receiving, holding or transferring foreign exchange. There are no delays for foreign exchange, which is readily available at market clearing rates and readily transferable through the banking system. Costa Rica had maintained a crawling peg exchange regime with the U.S. dollar since 1983, but in October 2006 transitioned to a crawling band regime designed to better control inflation, a persistent problem. While in 2005 Costa Rica had the second highest inflation rate in the western hemisphere, in 2006 the country posted its lowest inflation in over fourteen years, albeit at over nine percent. Dollar bonds and other dollar instruments may be traded legally. No restrictions are imposed on reinvestments or on the repatriation of earnings, royalties, or capital except when these rights are otherwise stipulated in contractual agreements with the government of Costa Rica. Royalties are taxed in accordance with Title IV of the Income Tax Law, No. 7092, extensively reformed in October 1988, at rates varying from 10 to 25 percent.

A.3. EXPROPRIATION AND COMPENSATION

Expropriation of private land by the government without prompt or adequate compensation has hurt some Costa Rican and foreign investors in the past. These incidents usually involved land expropriated to create national parks, indigenous reserves, or agricultural projects for poor farmers. One long-standing case involving a U.S. citizen still awaits settlement in the courts.

Article 45 of Costa Rica's constitution stipulates that no

property can be expropriated from a Costa Rican or foreigner without prior payment and demonstrable proof of public interest. The 1995 Law 7495 on expropriations further stipulates that expropriations can take place only after full and prior payment is made. Foreigners and Costa Ricans are supposed to receive equal treatment. Provisions include: a) return of the property to the original owner if it is not used for the intended purpose within ten years or, if the owner was compensated, right of first refusal to repurchase the property back at its current value; b) a requirement that the expropriating institution complete registration of the property within six months; c) a one-month period during which the tax office must appraise the affected property; d) a requirement that the tax office itemize crops, buildings, rental income, commercial rights, mineral exploitation rights, and other goods and rights, separately and in addition to the value of the land itself; and e) provisions providing for both local and international arbitration in the event of a dispute. The expropriations law was amended in 1998 to expedite some procedures, particularly those necessary for acquiring land for the construction of new roads.

Invasion and occupation of private property by squatters, who are often organized and sometimes violent, has occurred in Costa Rica. The squatters seek to take advantage of adverse possession devices in laws permitting occupants to receive title to unused farmland. The Costa Rican police and judicial system have at times failed to deter or to peacefully resolve such invasions. It is not uncommon for squatters to return to the parcels of land from which they have been evicted, requiring expensive and potentially dangerous vigilance over the land.

A.4. DISPUTE SETTLEMENT

Costa Rica uses the Roman civil law system rather than common law. The jury system is not used, although judicial reform efforts currently include testing the use of juries in some cases. The fundamental law is the country's political constitution of 1949, which grants the unicameral legislature a particularly strong role. The civil and commercial codes govern commercial transactions. The courts are independent, and their authority is respected. Judgments of foreign courts are generally accepted and enforced. The Constitution specifically prohibits discriminatory treatment of foreign nationals.

Monetary judgments are usually made in Costa Rican Colones. However, if the dispute involves a dollar-denominated transaction, the award may first be calculated in dollars and then converted to Colones for payment.

Litigation can be long and costly. The legal system is significantly backlogged, and civil suits take over five years on average from start to finish. Some U.S. firms and citizens have satisfactorily resolved their cases through the courts, while others have seen proceedings drawn out over a decade without a final ruling. The process to resolve squatter cases through the courts can be especially cumbersome. The legal owner of land can be at a disadvantage in a system that has recognized adverse possession rights acquired by squatters, especially when the disputed land is rural and is not being actively worked. Also, civil archives recording land title are at times incomplete or contradictory. These records should be carefully researched by potential buyers to avoid disputes over conflicting claims.

Arbitration

Arbitration has long been possible under the civil and commercial codes; U.S. investors have experienced mixed results from such proceedings organized by local attorneys. A 1998 law governing alternative conflict resolution (Law 7727) sought to encourage arbitration and simplify the procedures under which arbitration takes place. Several arbitration centers have since been established, including

one at the Costa Rican - American Chamber of Commerce. A few cases reportedly have been successfully and quickly resolved under the new law.

Costa Rica has been a member of the U.N.'s International Center for the Settlement of Investment Disputes (ICSID) since 1993, when it acceded to the Washington Convention. One land expropriation case was successfully resolved in that forum. Costa Rica is also a member of the World Bank Multilateral Investment Guarantee Agency (MIGA), which provides a forum for international arbitration in investment disputes, as well as investment guarantees. Private energy producers have included international arbitration clauses in their contracts. Costa Rica has not joined the United Nations Protocol for the Compulsory Settlement of Disputes between Countries or the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

Bankruptcy

The Costa Rican bankruptcy law, addressed in both the commercial code and the civil procedures code, is similar to corresponding U.S. law. Title V of the civil procedure code outlines creditors' rights and the processes available to register outstanding credits, administer the liquidation of the bankrupt company's assets, and pay creditors according to their preferential status Compared to other countries in the region, Costa Rican bankruptcy laws function less agilely, and affected creditors recover proportionally less from judgments, according to World Bank analysis.

A.5. PERFORMANCE REQUIREMENTS/INCENTIVES

Three investment incentive programs operate in Costa Rica: the free trade zone system, a so-called active finishing regime and a duty drawback procedure. These incentives are available equally to foreign and domestic investors. These incentives include tax holidays, free or subsidized infrastructure and industrial parks, training of specialized labor force, and protective tariffs in some cases.

The export processing law of 1981 established publicly operated free trade zone (FTZ) industrial parks in Santa Rosa (Puntarenas) on the Pacific Coast, and Moin (Limon) on the Caribbean seaboard. Presently, eight FTZs operate throughout Costa Rica, six of which are privately managed. Companies in FTZs receive exemption from virtually all taxes for eight years and at a reduced rate following this period. In addition to those benefits, companies operating in FTZs enjoy simplified investment, trade, and customs procedures. The tax holidays provided for investment in FTZs are scheduled to phase out in accordance with World Trade Organization (WTO) agreements. The Government of Costa Rica is considering a plan to equalize corporate income tax rates for all companies operating within the country, including companies operating in the FTZs.

The active finishing regime, created by decree in August 1997, suspends taxes for renewable six-month periods on imported inputs of qualifying companies, and then exempts the inputs from those taxes when the finished goods using or containing them are exported. The regime also facilitates a five-year renewable suspension of taxes on capital goods used to manufacture exported goods. Companies within this regime may sell to the domestic market if they have registered to do so and pay pro rata import duties on capital equipment used for the domestic market. Finally, the drawback procedure provides for rebates of duties or other taxes that have been paid by an iporter for goods subsequently incorporated into an exported good.

A.6. RIGHT TO PRIVATE OWNERSHP AND ESTABLISHMENT

All private entities and pesons, domestic or foreign may

establish and own businesses and engag in all but a few forms of remunerative activity. The exceptions are in sectors that are reserved for the state (legal monopolies) or that require participation of at least a certain percentage of Costa Rican citizens or residents (electrical power generation, broadcasting, professional services, and wholesale distribution). Many state-owned companies are monopolies, such as insurance, telecommunications, and energy. Under CAFTA-DR the first two monopolies will be phased out. In other activities, such as medical services, state firms operate, but do not preclude private sector competition, which generally receives equal treatment to state companies. Three banks owned by the state receive some advantages over their 15 private competitors, namely that they can not be forced into bankruptcy, a guarantee not afforded to private banks.

A.7. PROTECTION OF PROPERTY RIGHTS

Secured interests in both chattel and real property are recognized and enforced, and mortgage and title recording is mandatory. The laws governing investments in land, buildings and mortgages are generally transparent. However, there are continuing problems of overlapping title to real property and fraudulent filings with the national registry, the government entity that records property titles. The Costa Rican government does not prevent foreign title companies from operating. U.S. title firms have established operations in Costa Rica, including Stewart Title Company and First American Corp., which operates a subsidiary (First Costa Rican Title and Trust). Other U.S. title companies have announced plans to enter the Costa Rican market.

Investment in real estate requires care; some past investors have experienced problems with title and adverse possession by squatters. In the latter case, this often occurs where absentee owners of undeveloped or vacant rural properties confront a Costa Rican agrarian law regime that is relatively quick to confer title to occupants of land considered "abandoned." Landowners thus should be sure to demonstrate a continuing presence on and control over their land.

Investment in beachfront property in Costa Rica faces a unique set of circumstances. Almost all beachfront is public property for a distance of 200 meters from the high tide mark, an exception being in long established port cities. The first 50 meters from high tide cannot be used for any reasons by private parties and the next 150 meters, also owned by the state, can only be leased from the local municipalities for specified periods and particular uses, such as tourism installation, vacation homes, etc. Investors should exercise caution and obtain qualified legal counsel before purchasing property, particularly near beachfront areas. Potential investors in Costa Rican real estate should also be aware that the right to use traditional paths is enshrined in law and can be used to obtain court-ordered easements on land bearing private title. Disputes over easements are particularly common when access to a beach is an issue.

Intellectual Property Rights (IPR)

Costa Rica is a signatory of many major international agreements and conventions regarding intellectual property. It ratified the GATT agreement on Trade Related Aspects of Intellectual Property (TRIPS), which took effect in Costa Rica on January 1, 2000. Eight bills to implement the TRIPS agreement were passed by the Legislative Assembly in 1999 and 2000. One of these bills extended Costa Rica's patent protection to twenty years. CAFTA-DR requires significant strengthening of Costa Rica's IPR laws.

While the legal framework governing intellectual property is basically in place, enforcement is often ineffective. At the beginning of 2002, the Costa Rican Government announced steps to improve intellectual property protection

through a government strategy for improving the enforcement of IPR. Since then, the government has taken minor steps to increase enforcement efforts and to increase IPR training for judges and prosecutors. However, the current attorney general has publicly stated that given limited resources IPR enforcement is a low priority. In 2002 the United States Trade Representative (USTR) moved Costa Rica from the Priority Watch List to the Watch List in its annual Special 301 Report. In 2006 Costa Rica remained on the Watch List. According to the USTR, there remain deficiencies in Costa Rican intellectual property protection that have not been addressed. The USTR noted that significant delays in judicial proceedings and a lack of official investigators, public prosecutors and criminal and civil judges specializing in intellectual property continue to hamper effective enforcement. Since 2005 the U.S. Embassy in Costa Rica has actively recruited candidates for various IPR training seminars offered and funded by the United States Patent and Trade Office (USPTO). In late 2006, the U.S. Chamber of Commerce and the local American Chamber of Commerce announced an attempt to assess the scope of the piracy problem in Costa Rica using a polling technique the U.S. Chamber developed in Brazil.

A.8. TRANSPARENCY OF THE REGULATORY SYSTEM

Costa Rican laws, regulations and practices are generally transparent and foster competition, except in state monopoly sectors where competition is explicitly excluded. Tax, labor, health and safety laws are not considered to interfere with investment decisions. Environmental regulations and the Costa Rican organization that reviews environmental impact statements have caused problems for investors resulting in delays for completing projects. There are several independent avenues for appealing regulatory decisions, and these are frequently pursued by persons or organizations opposed to a public sector contract or regulatory decision. The avenues include the comptroller general (Contraloria General de la Republica), the ombudsman (Defensor de los Habitantes), the public services regulatory agency (ARESEP), and the constitutional chamber of the supreme court when constitutional rights appear to be affected. The attorney general's office (Procurador General de la Republica) is frequently a participant in its role as the government's attorney. The process has kept the regulatory system relatively transparent and free of abuse, but it has also rendered the system for public sector contract approval exceptionally slow and litigious. There have been several cases in which these review bodies have overturned contracts, thereby interjecting uncertainty into the process. Bureaucratic procedures are frequently long, involved and can be discouraging to new investors.

A.9. EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

There are no controls on capital flows in or out of Costa Rica or on portfolio investment in publicly traded companies. Larger investors arrange their financing abroad where rates tend to be lower and lending limits are higher. Foreign investors are able to borrow in the local market, but they are also free to borrow from abroad.

Within Costa Rica, long-term capital is scarce. Dollar-denominated mortgage financing is popular and common, even for Costa Ricans who do not earn their income in dollars because of more favorable lending terms for dollar-denominated vs. Colon-denominated loans. There is a small secondary market in commercial paper and repurchase agreements. The securities exchange (Bolsa Nacional de Valores) is small and is dominated by trading in government bonds. Stock trading is of limited significance and involves only a dozen of the country's larger companies. Volume traded is often in the range of $ 1 million per week. Stock ownership must be registered in the owner's name. Bonds may not be issued in bearer form.

Credit is allocated on market terms, although the state-owned banks are sometimes obliged to act as development banks for activities deemed to be of public interest. Credit is currently not available for intangible and or movable property such as future crops and equipment because such items can not be used as collateral under current law. The three state-owned commercial banks accounted for 60 percent of the banking system?s assets in December 2005. The fifteen private commercial banks had been steadily increasing their share of the market, but private banks are disadvantaged by the existence of implicit state guarantees for deposits in state-owned banks. Entreaties by private banks to establish deposit insurance for private deposits have so far been rejected by the state monopoly insurance provider.

Consolidated total assets of the country's public commercial banks were approximately USD 6.6 billion in July 2004, while consolidated total assets of the private banks were approximately USD 3.1 billion. The combined assets of all bank groups (including affiliated pension funds and brokerage houses) are approximately USD 14 billion.

Costa Rica's national council for the supervision of the financial system (CONASSIF) oversees Costa Rica's financial sector and consists of two principal components. The country's general superintendent of financial institutions (SUGEF) regulates banks and other financial institutions. The general superintendent of securities markets (SUGEVAL) oversees the securities exchange. The Costa Rican government is working to strengthen supervision of the financial sector with assistance from international donors.

Legal and accounting systems are transparent and consistent with international norms. Many well-known accounting firms in Costa Rica are affiliated with large U.S. firms.

A.10. POLITICAL VIOLENCE

Costa Rica has not experienced significant domestic political violence since 1948. There are no indigenous or external movements likely to produce political or social instability. In October 2006 public unions opposed to CAFTA-DR organized a two day national strike designed to disrupt normal business activity. Although they had threatened to bring the country to a halt, the unions were unable to mobilize the masses and at best the street demonstrations were an annoyance. These same groups have threatened similar actions in 2007.

A.11.a CORRUPTION

Costa Rica has laws, regulations, and penalties to combat corruption, though the resources available to enforce those laws have been limited. Corruption became a major issue in 2004, when two former presidents were placed in preventative detention on corruption charges; allegations of lower-level corruption are common, and some prosecutions have resulted. Amendments to make anti-corruption laws easier to interpret and apply, which had languished in the legislative assembly for years, were quickly passed in late ¶2004.

Costa Rica ratified the Inter-American Convention Against Corruption in February 1997. This initiative of the Organization for Economic Cooperation and Development (OECD) and the Organization of American States (OAS) obligates subscribing nations to implement criminal sanctions for corruption. The attorney general (Procuraduria General de la Republica), comptroller general (Contraloria General de la Republica) and ombudsman (Defensoria de los Habitantes) have mounted a common effort to combat corruption. The comptroller general, the organization of judicial investigation (OIJ), and the public prosecutors' office investigate allegations of corruption. The comptroller general is responsible for approving or rejecting auditing public contracts and detecting instances of corruption.

While most U.S. firms have not identified corruption as a major obstacle to doing business in Costa Rica, some have made allegations of corruption in the administration of public tenders. Developers of tourism facilities periodically cite municipal-level corruption as a problem.

Acts of bribery, including those directed against government officials, are criminal acts punishable by imprisonment. Public officials convicted of receiving bribes are subject to prison sentences from two to six years, according to the Costa Rican Criminal Code (Articles 314-315, and 338-339). Entrepreneurs may not deduct the proceeds of bribes or any other criminal activity as business expenses.

b. BILATERAL INVESTMENT AGREEMENTS

Costa Rica has Bilateral Investment Treaties (BITs) with Argentina, Canada, Chile, the Czech Republic, France, Germany, Great Britain, Korea, the Netherlands, Paraguay, Spain, Switzerland, Taiwan and Venezuela. Awaiting ratification in the legislative assembly are BITs with Belgium, Ecuador, Finland, and Luxembourg. Negotiation a bilateral investment treaty with the United States was suspended in 1990, restarted in 1996, and suspended again in 1997. The investment chapter of CAFTA-DR includes all aspects of a BIT thereby making the negotiation of a separate BIT unnecessary.

c. OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The Overseas Private Investment Corporation (OPIC) offers both financing and insurance coverage against expropriation, war, revolution, insurrection and inconvertibility for eligible U.S. investors in Costa Rica. OPIC can insure up to $200 million per project for U.S. investors, contractors, exporters and financial institutions. Financing is available for overseas investments that are wholly owned by U.S. companies or that are joint ventures in which the U.S. firm is a participant. OPIC holds a diversified portfolio of more than 300 clients.

U.S. investors should be aware that OPIC, in accordance with statutory requirements, may not offer insurance to projects with a detrimental effect on the U.S. balance of payments or employment. These statutory requirements have led OPIC to offer only limited insurance coverage for textile and citrus investments. The Government of Costa Rica approves prospective OPIC-insured projects taking into account possible balance of payments or labor problems. Costa Rica became a member of the Multilateral Investment Guarantee Agency, a member of the World Bank group, in ¶1993.

d. LABOR

The Costa Rican labor force is relatively well educated, skilled and easily trained, largely due to long-term government investment in public education. The country claims a literacy rate of 95 percent, and many workers seek and receive additional specialized training. Costa Rica's national vocational training institute (INA) and private sector groups provide technical and vocational training.

The rapid growth of Costa Rica's service and tourism sectors has created such demand for English-language speakers that foreign investors have recently been facing a shortage of workers with sufficient English language skills. The arrival of companies such as Intel, Procter and Gamble, Western Union, and various call center operators has drawn down the supply of speakers of fluent business and technical English. The Costa Rican Government has made English language and computer literacy a national priority at all levels of education. Several public and private institutions are attempting to meet the demand for English-language speakers, including the 50-year-old U.S.-

Costa Rican binational center (the Centro Cultural Costarricense Norteamericano), which offers general and business English courses to as many as 5,000 students year round.

Costa Rican law guarantees the right of workers to join labor unions of their choosing without prior authorization. Unions operate independently of government control and may form federations and confederations and affiliate internationally. Many Costa Rican workers join "solidarity associations," under which employers provide easy access to saving plans, low-interest loans, health clinics, recreation centers, and other benefits. Both solidarity associations and labor unions coexist at some workplaces, primarily in the public sector. Business groups claim that solidarity associations provide for better labor relations than exist in firms where unions represent workers and there are no solidarity associations. However, labor unions allege that private businesses use solidarity associations to hinder union organization in contravention of International Labor Organization rules.

The constitution protects the right of workers to organize. The Labor Code enacted in 1943 provides protection from dismissal for union organizers and members and requires employers found guilty of anti-union discrimination to reinstate workers fired for union activities. However, the labor courts are backlogged and the legal process can be lengthy.

e. FOREIGN TRADE ZONES/FREE PORTS

Free trade zones have been established near the port cities of Limon (Caribbean) and Puntarenas (Pacific) as well as in various central valley locations. The benefits, primarily fiscal, are described in Section A.5.

f. FOREIGN DIRECT INVESTMENT STATISTICS

Total Foreign Direct Investment Flows into Costa Rica

Year	Amount (USD million)	Percent of GDP
2005	861	4.3%
2004	794	4.3%
2003	577	3.4%
2002	662	4.1%
2001	454	2.8%
2000	409	2.6%

2005 Foreign Direct Investment by Country of Origin, Percent of Total

Country	Percent
USA	69.7
Canada	5.2
Mexico	4.2
Central America	2.8
Panama	4.3
Netherlands	1.0
Germany	0.6
Italy	0.4
Spain	1.9
Japan	0.0
Other	3.9
Total	100.0

2005 Foreign Direct Investment, by Sector

Sector	Amount (USD million)
Industry	345.0
Real Estate	235.0

Services	73.3
Tourism	53.5
Commercial	